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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 775

WILMINGTON TRUST COMPANY, EXECUTOR OF ALICE DUPONT ORTIZ, DECEASED,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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Argument.

Under the order of this Court granting certiorari, the question presented is whether the findings of the Board of Tax Appeals are supported by substantial evidence. That is the only question for consideration under this Court's order of January 12, 1942 (R. 659).

The respondent, attempting to avoid the real issue in this case, takes the position "that no factual issue is actually involved in this case because the undisputed evidence shows precisely how the sales in taxpayer's short account were made", and, consequently, that the only question raised by the record is one of law, namely, whether the sales in question were, for tax purposes, short sales as distinguished from sales of the taxpayer's long stock (Resp. B., p. 2). The respondent's entire argument is predicated upon that assumption, the error of which is patent when the opinion of the Court below and the findings of the Board are compared. Thus the Board of Tax Appeals, in reviewing the evidence upon which it based its findings of fact, said (R. 615-616):

> "If, as the respondent (Commissioner) says, delivery to the purchasers in this case was made from shares belonging to the brokers or their customers or from shares borrowed from other brokers, the sales clearly would be short sales. However, the facts are otherwise.
>
> "* * * In every instance where the long accounts contained shares equal to or greater in number than those sold, it was the practice of the brokers, acting under authority to treat all accounts as a unit, to treat the sales made through the short account as sales of the petitioner's (taxpayer's) long shares. * * * They credited the short account with the proceeds, made an entry therein showing delivery of the shares, and made entries in the long accounts reducing the number of shares held therein by the number sold through the short account. * * * That delivery from the long account was made at the time of the sale is established by the testimony of two employees of Laird & Co., who handled the stock records and dividend collections, and it is further corroborated by what was done when Laird & Co. took over the petitioner's (taxpayer's) accounts on October 1, 1932. * * * The witnesses further testified that in every case where the long posi-

tion exceeded the short position the broker did not borrow any stock from other brokers or other customers for the purpose of delivery."

The Circuit Court based its opinion squarely upon the facts and, with respect to the same evidence, said (R. 650):

"* * * Where dispositions of long stock occur, the proceeds are credited to the seller and are immediately available without restriction. Here, however, the money was withheld for no reason other than such a practice is consistent with a short sale.

"In arriving at its conclusion that the dispositions were not intended to be short sales, the Board relied upon the testimony of certain employees of taxpayer's broker. Considering the statements of these men in the light of their duties, the findings are unsupported. The particular function of a stock-clerk must be appraised in weighing his testimony and if a customer's long account had sufficient number of shares, deliveries were made out of that stock. As a stock-clerk he was concerned only with the net position of the broker. *From his testimony it cannot be said that the broker did not use borrowed stock to make deliveries on short sales.*" (Italics ours.)

The two quotations demonstrate beyond any doubt whatever that conflict exists between the Board and the Circuit Court; indeed, irreconcilable conflict between those two judicial bodies, not upon any principle of law, but *upon the basic facts of this case.* It is manifest that the Board based its conclusion upon the facts to which it referred, and the Court, in its opinion, reached an entirely opposite conclusion upon entirely different facts. The Court made no effort to overrule the Board upon a question of law, but it simply and directly set aside the facts found by the Board and substituted therefor other facts which appealed more strongly to the Court. In so doing, the

Circuit Court violated the rule announced in *Helvering* vs. *Kehoe*, 309 U. S. 277 (1940), where this Court said:

> "Upon review the Court may not substitute its judgment of the facts for that of the Board. *When there is substantial evidence to support the conclusion of the matter, this must be accepted.*" (Italics ours).

As pointed out in our first brief (p. 18), the Circuit Court disposed of the phase of the case here under consideration in two short paragraphs (R., p. 650). Those paragraphs deal with facts and facts alone. No reference is made to any applicable principle of law. The Court below did not so much as pretend to deal with the phase of the case here under review as a question of law; but, on the contrary, openly and bluntly set aside the facts found by the Board and substituted therefor the Court's own factual inferences. In view of the Circuit Court's opinion, it cannot be said, as the respondent contends, "that the only question raised by the record with reference to the sales * * *, is the issue of law whether or not they should be regarded, * * *, as sales of the taxpayer's long stock." (Resp. B., p. 2). On the contrary, the only question before this Court is whether or not there is in the record substantial evidence to support the Board's finding to the effect that the sales were not short sales.

Inferentially, at least, the respondent recognizes the soundness of the petitioner's contention that the conflict between the Court and the Board is squarely upon the facts of the case. There is not the slightest effort on the part of the respondent to sustain the findings of the Circuit Court or to support the reasoning contained in the Court's opinion. The respondent in his brief abandons the opinion of the Circuit Court and turns to the Commissioner's determination that the sales in contro-

versy were short sales (Resp. B., pp. 8, 9). Seizing upon the Commissioner's determination, an attempt is made to demonstrate that the findings of the Board of Tax Appeals were erroneous.

Respondent's Point I.

This portion of the respondent's brief is an endeavor to demonstrate that the Court below properly set aside the findings of the Board of Tax Appeals. The premise upon which the argument proceeds is that the differences between the Circuit Court and the Board were upon applicable principles of law. The most cursory comparison of the findings of the Board and the two paragraphs of the Court's opinion dealing with this phase of the case demonstrate that the premise is false.

In support of the argument that the sales in question were short sales, as decided by the Court, rather than sales of the taxpayer's long stock, as found by the Board, there are cited two cases decided by the Third Circuit Court of Appeals: *H. B. duPont* vs. *Commissioner,* 98 F. (2d) 459 (Certiorari denied 305 U. S. 631, No. 319 October Term 1938); *H. F. duPont* vs. *Commissioner,* 110 F. (2d) 641 (Certiorari denied 311 U. S. 657, No. 101 October Term 1940).

While each of those cases presented facts similar to those in the instant case, neither of them is pertinent, for the very simple reason that with respect to the sales involved in those cases, it was specifically stipulated:

> "Such deliveries were made by Laird, Bissell & Meeds either out of stock *borrowed* from other brokers, or from stock belonging to the customers of Laird, Bissell & Meeds in the possession of Laird, Bissell & Meeds, or from shares owned by Laird, Bissell & Meeds." (Italics ours.) (Par. 17 of Stipulation in the H. B. duPont case; Par. 27 of Stipulation in the H. F. duPont case.)

After a recital of the stipulated facts of the present case, unexplained by the testimony of the witnesses (Resp. B., pp. 12-16), the respondent finally comes to the crucial point of this case, namely, whether stock was borrowed in order to complete the sales under review. An effort is made (Resp. B., pp. 16-19) to explain away the clear and emphatic testimony that the taxpayer's stock was delivered to complete her sales (R. 538, 544), and that no stock was ever borrowed to complete them (R., 548, 553, 554, 556). The explanation at most reveals that the record contains evidence which had to be weighed and from which inferences of fact had to be drawn, and that a choice had to be made between conflicting inferences. The weighing of the evidence and the drawing of such inferences as had to be drawn from the proven facts were duties which rested exclusively within the jurisdiction of the Board of Tax Appeals. (Authorities cited in petitioner's first brief, p. 20.)

Realizing the futility of explaining away the testimony that the taxpayer's stock was delivered and no stock was borrowed, the respondent attempts to prove that the witnesses were mistaken and that, in fact, stock was borrowed. Pages 19 to 28 and 35 to 41 of the brief are given over to the contention that the witnesses' testimony to the effect that the taxpayer's "stock" was "delivered" does not mean delivery at all, because the "certificates" which were delivered in consummation of the sales could not be identified as the taxpayer's "certificates", since they were in street form.

The fallacy of this argument lies in the assumption that the word "stock" is synonymous with the word "certificates". In the course of the argument, those words are used interchangeably. The conclusion drawn is that since the certificates delivered cannot be identified as the particular "certificates" of the taxpayer, hence her "stock"

was not used and other "stock" must have been borrowed to complete her sales.

It is also urged that whether such delivery of street certificates not identifiable as the certificates of the taxpayer constitutes a borrowing of stock from the broker or from other customers of the broker, is a question of law. Unfortunately, at no point in his brief does the respondent say what the law is in such a case. After posing the question as one of law, there follows the conclusion that Wingate's testimony to the effect that no stock was borrowed (R., 548, 553, 554, 556) cannot affect the determination of the question. Such a conclusion is clearly erroneous, for that witness's testimony establishes that no stock was "borrowed" at all, whether from outside brokers, Laird & Company, or other customers of Laird & Company in order to complete the sales here under review (R., 553).

In its final analysis, the respondent's entire case is that since the taxpayer's certificates in street name were commingled by her broker with other similar certificates belonging to the broker and other customers, from which delivery was made on the taxpayer's sales, it cannot be said that her "stock" was delivered on her sales, and therefore it must be considered that the stock used for delivery was borrowed. Hence, the sales were short sales. The fallacy of such a position is obvious. The unsoundness thereof appears from the following illustration:

A customer purchases, let us say, 100 shares of Steel today. The certificate for the 100 shares is delivered to the purchasing broker in street name and placed in the broker's "box", in which are contained other certificates of Steel in street name. Next week the customer orders his broker to sell the 100 shares of Steel. The broker goes to the box, gets a certificate in street name for 100 shares of Steel—a certificate other than the one delivered on the purchase—and transfers it to the customer's vendee. Under

the respondent's theory, the customer has made a short sale. Obviously, such is not the case. If such an argument were to prevail, the result would be that most of the sales of securities in this country would be short sales, executed in direct violation of law; for most of the transactions on the Exchanges are in securities in street name. The fundamental error of the argument is rooted in the confusion of "stock" with "certificates", which are merely the evidence of ownership. Under the respondent's theory, an owner of a part of commingled fungibles, such as stock in street names, or grain in an elevator, upon selling his interest, effects a short sale unless the particular certificate or bushel of grain contributed by him to the commingled mass is delivered to his vendee.

Indeed, the record in this case proves the unsoundness of such a theory. Illustrative of other securities dealt in by the taxpayer is the stock of McKeesport Tin Plate. On October 2, 1932, at the time of the transfer of the taxpayer's accounts to Laird & Company, her long accounts showed 15,050 shares long (R., 168), while her short account showed 8,850 shares as being short (R., 208). Laird & Company actually received only the net amount of stock, namely, 6200 shares (R., 544). During the years 1932 and 1933, the taxpayer bought and sold various amounts of McKeesport Tin Plate, with the result that on January 1, 1934, her long account showed 6650 shares long and at the same time the short account showed a "short" balance of 6650 shares (R., 184, 232). Thus one account offset the other. Under the respondent's theory, the taxpayer, as late as September, 1934, still owned the 6650 shares of McKeesport Tin Plate stock appearing in her long accounts, and, under the same theory, necessarily the 6650 shares which she had sold through the short account were borrowed; because admittedly delivery had been made on the sales in the short account. The witnesses testified that no McKeesport Tin

Plate stock had been borrowed in order to complete the sales in the short account (R., 548).

Under the respondent's argument, the witnesses, in testifying that no stock had been borrowed, meant only that no stock had been borrowed from an outside broker, and since the certificates in street name were commingled with others in the broker's box, and the certificates delivered on the taxpayer's sales could not be identified as her particular certificates, therefore stock was borrowed, either from Laird & Company, or from other customers of Laird & Company. The fallacy of such an argument is demonstrated by the record, for Laird & Company owned no McKeesport Tin Plate stock (R., 546-7), and the only shares of that stock in its custody were 3725 shares which were being held in safe keeping for other customers and could not be used by the broker for any purpose whatever (R., 546, 610-11).

What we have said concerning the McKeesport Tin Plate stock is likewise true of the other securities dealt in by the taxpayer (R., 550-51, 554, 556).

An analysis of the record reveals that Laird & Company did not have a commingled mass of sufficient size to permit the borrowing therefrom of shares with which to cover the taxpayer's sales in her short account without using the taxpayer's own stock. This fact corroborates Wingate's testimony that no stock was borrowed. As to the McKeesport, he stated (R. 548):

> "Q. You mean you did not borrow the stock?
> A. That is right. We did not borrow the stock; that is why we did not charge a Federal tax."

As to duPont, he testified (R. 548):

> "Q. You did not borrow any?
> A. No."

As to Phillips Petroleum, he testified (R. 554):

"Q. Did you have any stock borrowed from anyone?
A. No, because there was an excess long of 200 shares."

. . . . . .

"Q. You had never borrowed stock from another customer?
A. We did not have to, because her long account had that much in it to offset the short account."

Again, with respect to Equitable Office Building, we find (R. 556):

"Q. Can you tell from this statement here whether you borrowed stock?
A. No, because at that time she had 1100 shares in her long account."

And with regard to Continental Diamond Fibre, the record states (R. 556):

"Q. Had you borrowed any stock?
A. We did not have to; one offset the other."

Respondent's Point II.

Pages 28 to 35 of the respondent's brief are addressed to a question which is outside of the issue upon which this Court granted certiorari. Therefore, we shall not burden the Court with an argument thereof. However, we feel compelled to challenge the statement (Resp. B., p. 29) to the effect that "the manner in which the taxpayer handled her accounts and recorded her sales was designed to permit her to take advantage" of certain tax factors set forth by the respondent and "it served no other purpose whatever." There is not one word of evidence in the record to indicate that the taxpayer kept her books and records as she did because of some supposed tax advantage which

might be achieved. The absence of any such evidence is a potent factor, in view of the fact that the taxpayer testified at length and was subjected to a detailed and searching cross-examination (R. 579-603). This argument on the part of the respondent is made for the first time in this Court, after death has sealed the lips of the taxpayer.

The case of *Higgins* v. *Smith*, 308 U. S. 473, is not apposite to the case before the Court, for there it was stated, by this Court, as a fact that the corporation with which Higgins dealt was his "corporate self" and "was created to gain these income and estate tax savings." Likewise, *Gray* v. *Powell*, No. 18 present Term, is distinguishable.

Conclusion.

The Board of Tax Appeals is the arbiter of the facts. That body has found as a fact that no stock was borrowed to complete the sales in question and, consequently, those sales were, in fact, not short sales. As was said in *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, 255 (1939):

> "These findings are supported by evidence which permits, at most, conflicting inferences and are, therefore, conclusive here."

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